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The pinball machines operated by Appellants during the period in question were multiple ball machines. The insertion of a coin into a slot in the machine releases the balls for play. The player propels each ball by means of a spring-activated plunger to the top of an inclined playing field. In the playing field are arranged bumpers, pins and scoring holes. This arrangement is such that the ball cannot drop into any hole without first striking one or more bumpers or pins. When a ball drops into a hole, the event is recorded on a scoring panel by lighted indicators. To win the game, balls must be placed in a certain combination of holes.

Additional coins (as many as 200 or more in some machines may usually be deposited in the machine. The deposit of such additional coins activates the machinery under the playing field and scoring panel which, in turn, may increase the scoring odds, alter the winning combinations, or provide additional balls to be played. The player, however, has no control over the effects which the deposit of additional coins will have.

There are controls inside the machine which can be adjusted in order to change the odds. These adjustments range from liberal to conservative, but the state of adjustment is not evident to the player. The machines are also equipped with anti-tilt controls. If the player jars or tilts the machine beyond a very limited degree, this control is activated and voids the player's score. The sensitivity of this control may also be adjusted, but again the state of adjustment is not evident to the player.

A counter in the scoring panel shows the number of free games won by the player. The free plays and the reading on the counter in the scoring panel may be removed by pushing a button set into the case of the machine. Inside the machine is another counter or meter which records the number of free plays which are removed by pushing the button, rather than by playing them. From the record before us it may be inferred that the purpose of these devices is to facilitate the redemption of free games for cash.

Arrangements by which the machines were placed in business establishments were not evidenced by written agreements or precise oral agreements. Some location owners requested Appellants to place pinball machines in their places of business while in other instances Appellants solicited the locations. The arrangements could be terminated at the will of Appellants or of the location owners. Appellants furnished the machines, maintained them and retained custody of the keys to the inside of the machines where the coin boxes were

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located. The location owners furnished space in their establishments for exposure of the machines to the playing public, generally made cash payouts to players who scored free games and, of course, held the keys to their establishments.

Periodically, Appellants or their employees called at each location and removed the coins from the machines. The coins were counted with representatives of both parties present. The location owner would at this time present a written record of his expenditures in connection with the machines since the last collection call. These expenditures consisted of cash paid to the players in lieu of free games, miscellaneous items such as cash paid by him for taxes or licenses, and refunds to players for machine malfunctions. The location owner's record of free plays redeemed was compared to the reading on the meter inside the machine which recorded the number of free games removed without being played. Even where the meter record of unplayed free games was substantially less than the location owner's record of free plays redeemed, however, the location owner's record was accepted as correct. The practice was to count out and set aside for the location owner an amount equal to the location owner's recorded expenditures. The remaining coins were divided equally between the Appellants and the location owner. The location owner would frequently then "buy" the Appellant's share of the coins from the collector in exchange for currency or a check in order to keep a supply of coins on hand for customers.

A record of each collection was made on a "Collection Report" a copy of which was left with the location owner. Enterea on this form was the date, name of location, net amount of money to divide and the amount of the net retained by each party. The report was signed by the location owner and the collector. Although space was provided on the form for entry of the total amount in the machine, this figure was not recorded.

The Franchise Tax Board takes the position that Appellants were the operators of the pinball machines and rented space for the machines from the location owners. In reliance upon this position it redetermined Appellants' gross income from the machines. It computed such gross income by starting with the amount actually received and reported by Appellants and adding thereto (1) the amounts retained by the location owners as their share of the net amounts in the machines and (2) the amounts retained by location owners as reimbursement for pay-outs and other expenditures in connection with the machines. In other words, the gross income of Appellants was considered by the Franchise Tax Board to include the gross proceeds of their machines.

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Since Appellants kept no record of the gross proceeds of the machines, the Franchise Tax Board reconstructed the gross income upon the basis of available information. For this purpose it estimated that payouts and other reimbursable expenditures by the location owner aggregated 40 percent of the gross proceeds of the machines. This percentage was based upon information gathered from interviews with Appellants and location owners. Using this percentage and the net machine proceeds shown on the "Collection Reports," the Franchise Tax Board determined the aggregate gross proceeds of the machines and included this amount in Appellants' gross income. Upon the theory that substantially all of Appellants' gross income was derived from illegal gambling activities, the Franchise Tax Board, acting under Section 17359 (now Section 17297) of the Revenue and Taxation Code, allowed no deduction therefrom.

During the period in question Section 17359 provided as follows :

"In computing net income, no deduction shall be allowed to any taxpayer on **any** of his gross income derived from illegal activities as defined in Chapters 9, 10 or 10.5 of Title 9 of Part 1 of the Penal Code of California; nor shall any deductions be allowed to any taxpayer on any of his gross income derived from any other activities which tend to promote or to further, or are connected or associated with, such illegal activities."

Appellants contend that their pinball machines were rented to and operated by the location owners. The periodic division in the manner hereinbefore described of the receipts derived from operation of the machines was, in their view, merely a means of computing the rentals payable by the location owners for the use of the machines. It is Appellants' position, accordingly, that they were not engaged in an illegal activity and that no part of the proceeds from operation of the machines, other than the amounts received by them as rent, was includible in their gross income. In the alternative, they allege that their arrangement with each location owner amounted at most to a joint venture. They also assert that the Franchise Tax Board overestimated the percentage of payouts; that the mere possession of pinball machines is not illegal; that such machines are exempted from the prohibitions of Sections 330(b) and 330.1 of the Penal Code by Sections 330(b)(4) and 330.5 of that Code; and that any payouts for free plays were made by the location owners. Finally, they argue that Section 17359 of the Revenue and Taxation Code is unconstitutional on several grounds.

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Some of the constitutional objections raised by Appellants with respect to this section were disposed of in Hetzel v. Franchise Tax Board, 161 A.C.A. 259. In any event, in accordance with our well established policy, we will not pass upon the constitutionality of a statute in an appeal involving unpaid assessments, since a finding of unconstitutionality could not be reviewed by the courts (see Appeal of Tide Water Associated Oil Co., decided June 3, 1948).

We agree with Appellants that the mere possession of a pinball machine does not constitute a crime (Sharpensteen v. Hughes, 162 A.C.A. 406). Where, however, there are cash pay-offs for free games scored on a pinball machine, the result or operation of which depends upon chance, there is a violation of Section 330(a) of the Penal Code. This section, which is among those referred to in Section 17359, provides:

"Every person, who has in his possession or under his control, either as owner, lessee, agent, employee, mortgagee, or otherwise, or who permits to be placed ... in any ... space ... leased ... by him ... any slot ... machine, contrivance, appliance or mechanical device, upon the result of action of which money ... is staked or hazarded, and which is operated, or played, by placing or depositing therein any coins ... and by means whereof, or as a result of the operation of which any ... money ... is won or lost ... when the result of action or operation of such machine ... is dependent upon hazard or chance ... is guilty of a misdemeanor ..."  
(See Gayer v. Whelan, 59 Cal. App, 2d 255; 8 Ops. Cal. Atty. Gen. 312.)

The evidence before us leaves no doubt that the winning of free games by players of pinball machines owned by Appellants was dependent upon hazard or chance. The redemption for cash of free games, accordingly, would constitute the operation of such machines a violation of Section 330(a) of the Penal Code. Nor do Appellants seriously contend otherwise. Whether there was also a violation of Sections 330(b)(4) or 330.5 of the Penal Code we need not decide.

One of the Appellants testified that during the period in question it was the general practice to make payouts and that new location owners were so informed. A former employee of Appellants testified that most of the location owners were making payouts and that he had witnessed payouts being made.

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The statements of two location owners were that payouts were made in their respective establishments in connection with the Appellants' machines.

The testimony of witnesses associated with the operation of the machines revealed estimates of the percentage of payouts from 25 percent to over 50 percent. One of the Appellants estimated the percentage at 33-1/3 percent. A machine mechanic and collector employed by Appellants during the period in question estimated that reimbursements to location owners for payouts averaged 40 to 50 percent of total machine receipts. The owner of a location in which Appellants' machines were operated estimated over 50 percent of receipts had been paid out. Another location owner in a statement to the Franchise Tax Board seemed unable to make any estimate but indicated that the percentage of payouts in some instances might be as low as 23 percent. His wife estimated that payouts in connection with Appellants' machines in their establishment averaged 40 percent of machine receipts. Upon consideration of all of the facts and the estimates of witnesses, both as to the prevalence of payouts and the ratio of such payouts to total receipts, we are of the opinion that the Franchise Tax Board's estimate that payouts and other reimbursable expenditures by the location owner aggregated 40 percent of machine receipts was reasonable and fair.

Moreover, we think that the evidence convincingly demonstrates that Appellants and the location owners participated in the operation of the pinball machines in violation of Section 330(a) of the Penal Code. Appellants contributed the use of their machines, technical knowledge and maintenance. Each location owner contributed space in his establishment, supervision of the play and the service of making the payouts. Appellants were aware of and discussed with location owners the making of payouts. The cash outlays for such payouts, as well as for other operating expenses such as license fees, refunds for tilts, etc. were shared by Appellants and the location owners, as were the net proceeds from machine operations. We are of the opinion, accordingly, that the arrangement between Appellants and each location owner constituted a joint venture for the operation of the pinball machines. . Horace and Rudy A. Miller v. Commissioner, 5 T.C. 691.; Charles A. Clark v. Commissioner, 19 T.C. 48.

a The consequence of our finding that Appellants were joint venturers with each location owner is to reduce by one-half the income attributed to them by the Franchise Tax Board. Appellants have argued, however, that even if they were joint venturers with the location owners, the entire amount of the

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payouts is excludable from their income, relying on Automatic Cigarette Sales Corp. v. Commissioner, 234 Fed. 2d 825. The court there held that money used to pay a fine levied on a location owner, and taken from his share of slot machine proceeds, was income of the machine owner. The finding that the money was income of the machine owner, however, was based on the view that the business was his and that he merely paid part of the proceeds to the location owner for the use of the premises. On the other hand, where there was found to be joint participation between a machine owner and a location owner, and money for a fine was taken from the proceeds before their division by the parties, it was held that one-half of the money for the fine was income of each party (Clark v. Commissioner, supra). In the case before us there was joint participation and the gross intake of each machine was the income of both participants. The payouts were joint expenses, the deduction of which is prohibited by Section 17359.

While Appellants concede that a presumption of correctness ordinarily attaches to the assessment of a deficiency by the Franchise Tax Board, they argue strenuously that when the assessment involves a charge of wrongdoing the Franchise Tax Board has the burden of proving the amount of the deficiency. They rely on Marchica v. State Board of Equalization, 107 Cal. App. 2d 501, and Speiser v. Randall (June 30, 1958) U.S. \_\_\_\_\_, 2 L. Ed. 2d 1460. In the first of the cited decisions the court held that the burden of proving fraud was on the government when the statute of limitations would have otherwise been a bar to the assessment. It specifically noted, however, that the "deficiency is to be presumed to be correct as to the amount of the tax and interest, and the taxpayer has the burden of overcoming the presumption." In Speiser v. Randall the Supreme Court of the United States held invalid on constitutional grounds a California statute which required a claimant for exemption from property tax to file a declaration that he does not advocate the overthrow of the government of the United States or the State by force or violence. The statute there under attack required the claimant to prove affirmatively his innocence of the crime of conspiring to overthrow the government. The matter at hand is clearly distinguishable since Appellants are required only to disclose the amount of their gross income and the amount and nature of their deductions. There is no burden cast upon them to prove affirmatively their innocence from crime or other wrongdoing.

The suggestion that the burden of proving wrongdoing carries with it the burden of proving the amount of the tax deficiency has been rejected by the United States Circuit Court of Appeals in Snell Isle, Inc. v. Commissioner, 90 Fed. 2d 481. The Commissioner had determined deficiencies against the tax-

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payer and assessed a fraud penalty of 50 percent of the amount thereof. The taxpayer contended that the "burden was on the Commissioner not only to show fraud, but also to show that the returns as made were otherwise not correct, on the ground that the deficiencies determined were based on disallowances of certain items upon which the, charge of fraud was also predicated." (Emphasis added.) To this the Court stated that ~~while~~ the Commissioner had the burden of proving fraud, the burden still remained on the taxpayer to overcome the presumption arising from the Commissioner's ruling as to the amount of taxes actually due,

Appellants are amenable to the Personal Income Tax Law and are required under the provisions thereof to file returns, report their entire gross income, and to establish the amount and nature of their claimed deductions. There is no waiver of these requirements as respects taxpayers who derive their income from illegal activities, or activities which "tend to promote or to further, or are connected or associated with such illegal activities," Appellants having failed to report their entire income, or to keep books and records adequately reflecting such income, the Franchise Tax Board was justified in determining the deficiency of taxes by such other information as it had available. Its determination of the amounts of income and deductions is prima facie correct and the burden of proving error is on Appellants. Max Cohen, 9 T.C.1156, aff'd. 176 Fed. 2d 394; Leonard B. Willits, 36 B.T.A. 294; and Richards v. Commissioner, 111 Fed. 2d 376 In disposing of this appeal it may be assumed, without deciding (see Hodoh v. United States, 153 Fed. Supp. 822, p. 824), that the Franchise Tax Board had the burden, for purposes of Section 17359 (now Section 17297), of proving that Appellants' operation of a pinball machine business constituted an illegal activity proscribed by Chapters 9, 10 or 10.5 of Title 9 of Part 1 of the Penal Code, or that such business tended to "promote or to further," or was "connected or associated with," such illegal activities. In our opinion the Franchise Tax Board has adequately established that Appellants participated in the operation of pinball machines in violation of Section 330(a), Chapter 10 of Title 9 of Part 1 of the Penal Code, Section 17359 of the Revenue and Taxation Code, therefore, precluded the allowance of any deductions from gross income derived from this source.

A portion of Appellants' income appears to have been derived from certain devices described as arcade machines and shuffle alleys. No issue has been raised or arguments made concerning them. Since the evidence before us indicates that these devices are also games of chance in connection with which prizes were awarded, we have no basis for making any adjustment to the estimated proceeds from their operation.



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O R D E R

Pursuant to the views expressed in the Opinion of the Board on file in this proceeding, and good cause appearing therefor,

IT IS HEREBY ORDERED, ADJUDGED AND DECREED, pursuant to Section 18595 of the Revenue and Taxation Code, that the action of the Franchise Tax Board on protests to proposed assessments of additional personal income tax against C. B. Hall, Sr., and Gertrude Hall in the amounts of ~~\$3,003.04~~ and ~~\$4,222.25~~ for the years 1951 and 1952, respectively; against Charles B. Hall, Jr., and Sally Hall in the amounts of ~~\$3,047.56~~ and ~~\$3,997.49~~ for the years 1951 and 1952, respectively; and against Edward F. Brown and Charlotte Brown in the amounts of ~~\$3,079.68~~ and ~~\$4,297.94~~ for the years 1951 and 1952, respectively, be and the same is hereby modified as follows: the assessments are to be reduced by (1) withdrawal of negligence penalties against all Appellants, (2) allowance to Appellants C. B. Hall, Sr., and Gertrude Hall of a bad debt deduction in the amount of ~~\$2,214.33~~ for the year 1951 and (3) recomputation of the gross income of the Appellants in accordance with the Opinion of the Board. In all other respects the action of the Franchise Tax Board is sustained,

Done at San Francisco California, this 29th day of Dec., 1958, by the State Board of Equalization.

George R. Reilly, Chairman

J. H. Quinn, Member

Paul R. Leake, Member

Robert C. Kirkwood, Member

\_\_\_\_\_, Member

ATTEST: Dixwell L. Pierce, Secretary